

**00786**

**1986/04/14**



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(U) TAIWAN-PRC ECONOMIC RELATIONS

Summary

(U) Annual indirect trade between Taiwan and the People's Republic of China (PRC) now totals about \$1.6 billion, three-quarters of which is exports from Taiwan. Because many businesses--including major Japanese trading companies--are becoming more active in pursuing such trade, it may continue to grow at an average rate of 15-20 percent a year for quite some time. Thus, Taiwan's indirect exports to the PRC may total \$3 billion in 1990 and \$6-8 billion in 1995. PRC exports to Taiwan are unlikely to exceed \$2 billion by 1995 if trade continues to be conducted on only an indirect basis.

(C) Were Taipei to change its current policy and permit completely open trade with the PRC, Taiwan might export \$15-20 billion a year to the mainland within 10 years. PRC exports to Taiwan could rise as high as \$5-10 billion. In such an eventuality, Taiwan would be able to boost its average annual economic growth rate from an expected 5-6 percent to probably 7-9 percent through the end of the century. While the larger PRC economy would not gain much in terms of economic growth from direct trade with Taiwan, the political benefits of such trade might strengthen the hands of those favoring economic pragmatism and, thus, indirectly help to sustain high rates of growth on the mainland.

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Overview

(C) While the authorities on Taiwan forbid their people to trade directly with the PRC, Beijing encourages trade with Taiwan and admits

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Declassify: OADR (Lindstrom, R.)

Report 1261-AR  
April 14, 1986

16/10/81  
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Taiwanese goods duty free. Indeed, the term "indirect trade" is a little misleading. Although Taiwan's entrepreneurs do not negotiate directly with their counterparts in the PRC, they generally work knowingly with intermediaries in Hong Kong and elsewhere. These intermediaries have broad authority and generally get all parties to agree to technical issues--e.g., quality and quantity specifications, time of delivery, shipping procedures, and methods of payment--before goods leave Taiwan.

(C) Of the \$1.6 billion annual indirect two-way trade between Taiwan and the Chinese mainland, 60-70 percent is conducted through Hong Kong with the remainder going through Japan, members of the Association of Southeast Asian Nations (ASEAN), and via clandestine exchanges among fishermen in the Taiwan Strait (see table p. 3):

- Relatively reliable statistics show Taiwan exported about \$800 million to the PRC via Hong Kong in 1985 and took back about \$200 million in imports. Exports have been largely textile and other industrial inputs, building materials, and electrical consumer goods. Imports have consisted mostly of agricultural products, and herbs and traditional Chinese medicines.
- Trade via Okinawa, Singapore, and other ASEAN ports is difficult to quantify. But many shipping firms serve all the ports of the area, and it is possible that \$300 million is channeled through these ports.
- PRC officials in Fujian Province claim that some 2,000 Fujian and Taiwan fishing boats engage in trade on the high seas. Such trade involves a large variety of agricultural and industrial products and allegedly totals another \$300-plus million a year.

(U) It is notable that major Japanese trading companies with well-established offices in both the PRC and Taiwan are now becoming more venturesome in indirect trade. Their growing activities, combined with the continually expanding operations of the small, regional entrepreneurs who traditionally have led the market, make it more likely that such trade can continue to expand at a prodigious, though probably fluctuating, rate for several more years.

(U) Fluctuations in trade in the past few years have been significant. Taiwan's exports to the PRC grew several fold in 1980 and 1981. Then in 1982 and 1983 they declined almost 30 percent--owing in part to PRC efforts to restrain all imports, as required by its International Monetary Fund program, and in part to a crackdown by Taiwan's authorities. In 1984, Taiwan's exports to the mainland boomed again, more than doubling their 1983 level. In 1985, such exports were up another 85 percent.



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export markets can be expanded. Most less developed countries and European markets are not good candidates for expansion because they are limited by debt problems and trade barriers.

(C) The large and growing PRC market has no debt problems, however, and officially welcomes goods from Taiwan. Consulate General Hong Kong reports:

"Beijing appears to be placing more importance on its trade with...South Korea and Taiwan. The success of these newly industrializing Asian economies has given them the kind of intermediate technology that China considers appropriate for its development needs and is eager to acquire."

(U) Present projections by Data Resources, Inc. (DRI) and others indicate the PRC's GNP in 1995 will be almost twice as large as the present United Kingdom economy or about equal in size to the present West German economy. Although the PRC recently has curbed imports of consumer goods--because trade deficits in 1984 and 1985 grew extremely rapidly--its long-term plan is for steady and significant growth in trade through the end of the century.

(U) Major categories of exports from Taiwan that are likely to grow rapidly--particularly in the event of direct trade--include chemicals, textile inputs and machinery, industrial fasteners, machine tools, pumps, agricultural machinery, motor-cycles, automotive parts, construction materials, communication equipment, electrical-power apparatus, canned goods, and dairy products. On the other side of the ledger, the PRC could potentially export significant amounts of grain, soybeans, cotton, coal, oil, and mineral products to Taiwan each year.

#### (U) Trade Balances

The PRC views Taiwan as a part of China and sees increased trade as a step toward eventual reunification. It is likely, therefore, that the PRC would tolerate a large bilateral deficit as long as its worldwide current account was in surplus or close to balance. Current forecasts by DRI indicate that the PRC will have significant current account surpluses for the decade of the 1990s. Those forecasts assume no direct trade with Taiwan but imply that indirect imports will be \$6-8 billion in 1995.

Were direct trade to develop, the PRC probably would still maintain a worldwide surplus on its 1995 current account, even if it imported as much as \$20 billion from Taiwan. Likely moderate reductions in potential imports from other nations and moderate increases in exports to Taiwan would leave the PRC with a 1995 worldwide current account surplus of as much as \$4 billion--versus \$9 billion as now forecast.

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In this scenario, about 15 percent of Taiwan's exports (or 9.5 percent of GNP) would be flowing to the PRC, and Taiwan would account for roughly 25 percent of PRC imports--or a share equal to that of Japan in 1985. Potential PRC exports to Taiwan of \$5-10 billion would account for about 4-8 percent of Taiwan's imports and equal 2-5 percent of Taiwan's GNP.

#### Potential Benefits of Open Trade

(U) At the currently expected 5-6 percent average annual growth rate, Taiwan could achieve the present US standard of living (per capita GNP) in 35 years and draw even with the US in about 75 years. At an 8-percent rate of growth, Taiwan would achieve present US standards in about 25 years, and equality in about 35 years. While it is unlikely that Taiwan could maintain an 8-percent growth rate for another 35 years, the point remains that the longer it can stay at the higher rate the faster it will approach US standards. (These projections assume annual population growth of 1.1 percent in Taiwan and 1.0 percent in the US, plus annual US GNP growth of 3.3 percent.)

(C) Because the economy of the PRC is much larger than that of Taiwan and its trade alternatives are more numerous, an increase in PRC-Taiwan trade is not likely by itself to have much of an effect on the PRC's rate of growth. To the extent that expanded trade brings less ideological resistance, however, and a better understanding of the market-oriented development policies Taiwan has so successfully pursued over the years, the whole process might marginally help to sustain and strengthen economic and political pragmatism in the PRC.

(C) The PRC might find particularly attractive Taiwan's strategies for stimulating savings, constraining inflation, pricing capital, distributing loanable funds, maintaining low debt servicing-to-export ratios, and structuring customs duties. If the PRC tailored such strategies to its own situation and otherwise continued to improve its economic policies, it could sustain its recent pattern of economic growth and thereby challenge the records of the Asian tigers of the last three decades.

#### Political Considerations

(C) The large PRC economy and its tightly controlled social system face no objectively significant economic or security risks from greatly expanded, completely open trade with Taiwan. Successfully coaxing Taiwan into normalizing trade would significantly bolster the domestic power and prestige of the pragmatists in the PRC, largely because it would be seen as a step toward reunification. Opponents of reform, on the other hand, might seize upon the threat to Communist social objectives from exposure to the

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REF ID: A66666

"ideologically polluting" lifestyle on Taiwan--no matter how minor--as part of their challenge to the pragmatists. The defeat of pragmatism clearly would require much more than dissension over the issue of trade or cultural interaction with Taiwan, however.

(C/NF) On the other side of the strait, Taiwan's dominant political leaders remain strongly opposed to any and all contact with the PRC. Still bitter over both the civil war they lost on the mainland in 1949 and the suffering imposed on China during the Mao years, the older leaders on Taiwan view the Communist Party as totally evil. Younger leaders oppose political reconciliation, much less reunification, with the PRC as a threat to Taiwan's social stability, as well to their own political primacy on the island. Indigenous Taiwanese fear that any form of reconciliation could lead to yet another government dictating to them just when they may be allowed to participate more fully in the present one.

(C) In addition to their deep-seated enmity toward the PRC's leadership are several factors which are stressed by Taiwan's policymakers in arguing against the opening of trade:

- They fear that Taiwan's highly mobile, accessible, and fractionated society could be deeply penetrated by PRC propaganda and subversive activities if travel and trade across the Taiwan Strait grew significantly.
- They fear that Taiwan's smaller economy would become tied to the political and economic fluctuations of the PRC if Taiwan were to export a substantial share (e.g., 15 percent) of its GNP to the PRC. Even the current 3 percent of exports or 1.5 percent of GNP going to the PRC worries key Taiwan policymakers, and they could well move to restrict indirect trade if it continues to boom (it grew almost fourfold between 1983 and 1985).
- They assert that, were the PRC to decide for political reasons abruptly to cease buying several billion dollars worth of Taiwan's annual exports, Taiwan would have difficulty finding alternative buyers fast enough to avoid large-scale unemployment, domino-style defaults on debt, and severe economic dislocation.

(U) The Open-Trade Debate

While there is virtual unanimity on Taiwan against political reconciliation with the PRC, many business leaders and a few policymakers have cautiously suggested that direct trade could be safely developed. Pointing out that export opportunities are becoming limited in traditional industrial markets and difficult and dangerous to pursue in many debt-ravaged developing countries,

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they say the possibility of trade with an increasingly pragmatic PRC should not be dismissed out of hand. They argue that the faster economic growth derived from open trade with the PRC not only would generate higher consumption, plus investment in plants producing for export, but also would permit greater investment in housing, roads, schools, hospitals, laboratories, research centers, and new technologies.

Addressing the issue of possible fluctuations in trade owing to political decisions or turmoil on the mainland, Taiwan's advocates of open trade argue that the authorities on Taiwan could insulate the island against the more serious results of such fluctuations by (a) significantly increasing foreign exchange reserves as trade with the PRC rose and (b) requiring firms trading with the PRC to maintain low debt/equity ratios, strong balance sheets, and substantial trade relations with other markets.

There have been relatively open seminars on these issues in Taiwan in the last few years which have been fairly well covered by the media on Taiwan. Each year a growing number of Taiwan passport holders quietly, if illegally, visit the PRC. And even an article written by a staff member in the recent "Economic Quarterly" of the government-funded Chung Hua Institute in Taiwan has said, in the strongest possible terms, that increased trade with the PRC could greatly benefit Taiwan's economy and be carried out in a safe manner.

On the other hand, several well-publicized arrests and trials of businessmen and fishermen negotiating large direct deals with the PRC--reportedly including investments in plant--have forestalled any vigorous movement to liberalize trade.

(C/NF) Outlook

If the PRC continues its current, relatively patient attitude toward eventual reunification and also continues its progress toward internal political stability and economic pragmatism, KMT leaders probably will acquiesce indefinitely in the moderate rate of growth in indirect trade of perhaps as much as 15-20 percent a year for the next decade. Neither a faster rate of growth, nor direct trade, nor investment in the PRC is likely to be sanctioned by Taiwan for the foreseeable future.

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